



Comptroller General
of the United States

Washington, D.C. 20548

Decision

Matter of: General Kinetics, Inc., Cryptek Secure
Communications Division

File: E-243078.2

Date: January 22, 1992

Richard J. Conway, Esq., and David M. Nadler, Esq.,
Dickstein, Shapiro & Morin, for the protester.
Gerard F. Doyle, Esq., and Scott W. Woehr, Esq. Doyle &
Bachman, for Ilex Systems, Inc., an interested party.
Kenneth J. Allen, Esq., and Gerald P. Kohns, Esq.,
Department of the Army, for the agency.
Glenn G. Wolcott, Esq., and Paul I. Lieberman, Esq., Office
of the General Counsel, GAO, participated in the preparation
of the decision.

DIGEST

1. In determining whether product was "domestic end product" for purposes of the Buy American Act, agency properly applied general and administrative expense to components manufactured in-house by offeror, but not to components purchased from outside suppliers.
2. Protester's representation that it could manufacture certain components at a cost approximately 35 percent lower than the awardee's cost does not establish that awardee misrepresented its costs or that those costs were otherwise unreasonable.

DECISION

General Kinetics, Inc., Cryptek Secure Communications Division (Cryptek) protests the Department of the Army's award of a contract to Ilex Systems, Inc. (Ilex) under request for proposals (RFP) No. DAEA08-91-R-6000 for digital facsimile (fax) terminals to support the Technology Applications Office, 7th Signal Command, United States Army. Cryptek contends that the fax terminals offered by Ilex should have been evaluated as foreign end products for purposes of the Buy American Act, 41 U.S.C. § 10a et seq. (1988), and that the contracting officer's decision to award a contract to Ilex did not reflect her own independent judgment.

We deny the protest.

BACKGROUND

On January 17, 1991, the Army issued RFP No. DAEALF-91-F-6000, requesting proposals to provide digital fax terminals. The RFP contemplated award of a firm, fixed-price contract for 1 base year and 4 option years and provided that award would be made on the basis of the lowest priced, technically acceptable proposal.

The RFP incorporated the requirements of the Buy American Act through inclusion of the Defense Federal Acquisition Regulation Supplement (DFARS) clause titled "Buy American Act, Trade Secret, Trade Agreements Act," and the DFARS certificate titled "Buy American-Trade Agreements-Balance of Payments Program." See DFARS §§ 252.225-7001 and 252.225-7005 (1988 ed.). Pursuant to the Buy American Act and its implementing regulations, an evaluation differential is to be applied to the price of offers proposing to furnish "foreign end products" when those offers are competing with offers of "domestic end products."¹ The DFARS defines a "domestic end product" as an "end product manufactured in the United States if the cost of its . . . components which are mined, produced or manufactured in the United States exceeds 50 percent (50%) of the cost of all its components." DFARS § 252.225-7001(a). "Components" are defined as "those articles, materials and supplies directly incorporated into end products." id.

On or before the closing date for submission of proposals, Ilex and Cryptek each submitted technically acceptable proposals indicating that each was offering domestic end products for purposes of the Buy American Act.² By letters dated May 10 and May 13, Cryptek notified the contracting officer that it believed the products offered by Ilex did not qualify as domestic end products. In that correspondence, Cryptek advised the agency which foreign and domestic components it believed were included in Ilex's fax terminals, and included Cryptek's estimates of the costs of each component.

By letter dated August 5, the contracting officer asked Ilex to provide her with "cost, labor and material data"

¹Under the terms of the clauses applicable to this solicitation, the differential to be applied ranged from 6 percent of the offered price inclusive of duty, to 50 percent of the offered price exclusive of duty, whichever resulted in the greater evaluated price. DFARS § 252.225-7001(d).

²The agency also received proposals from other offerors which are not relevant to this protest.

demonstrating whether the fax terminals it was offering qualified as domestic end products for purposes of the Buy American Act. Ilex responded by letters dated August 6, August 19, and August 21, providing the contracting officer with a "product tree" identifying 15 components of its fax terminals. Ilex advised the contracting officer that five of the components were manufactured in-house at Ilex's facility in California; nine of the components were domestically manufactured by other suppliers from whom Ilex purchased the components in completed form; and one component was manufactured in Japan and purchased as a foreign component.

For each component manufactured in-house, Ilex provided the contracting officer with a cost breakdown identifying direct material costs, the number of direct labor hours associated with the component's manufacture, the applicable labor rates, the factor used for burdening direct labor with Ilex's manufacturing overhead, and Ilex's general and administrative (G&A) expense factor which it applied to components it manufactured in-house. For the purchased components, Ilex listed the price it paid each supplier; Ilex did not apply either manufacturing overhead or G&A to the costs of the purchased components.

The contracting officer, in conjunction with various agency technical personnel and attorneys, reviewed the data Ilex submitted, and after excluding the costs of certain domestic components claimed by Ilex,¹ determined that the cost of the domestic components of the fax terminals Ilex was offering exceeded the cost of the foreign components. Based on these calculations, the contracting officer concluded that Ilex's fax terminals were domestic end items within the meaning of the Buy American Act and, accordingly, did not apply any differential to Ilex's price. Ilex's proposal was evaluated as offering the lowest price, and a contract was awarded to it on September 6. This protest followed.

CALCULATION OF COMPONENT COSTS

Cryptek first protests that the agency's component cost calculations were flawed because they applied no burden, that is, overhead and G&A expense, to the cost of the foreign component. Cryptek argues that, at a minimum, the foreign component should have been burdened with G&A costs and that addition of G&A expense to the cost of the foreign

¹For purposes of the Buy American Act calculation, the contracting officer refused to include Ilex's costs for fax paper, its packaging costs, the costs of preparing user manuals, and other incidental costs thereby decreasing Ilex's domestic component costs.

component would have resulted in award of the contract to Cryptek.⁴ Cryptek maintains that the failure to apply G&A to the foreign component violated the requirements of the Buy American Act since such treatment of costs is inconsistent with the Cost Accounting Standards (CAS) and the cost accounting principles in Part 31 of the Federal Acquisition Regulation (FAR) regarding allocation of G&A expenses. See 4 C.F.R. § 410.40 (1991); FAR § 31.201-4.

As noted above, the regulations implementing the Buy American Act clearly provide that the determination regarding whether an offered end product is foreign or domestic is based on a calculation of component costs; however, neither the Buy American Act nor its implementing regulations define the term "cost" with regard to the necessary component cost calculation, nor do they indicate that Buy American Act cost calculations are to be performed pursuant to the cost principles of the CAS or Part 31 of the FAR.

Contrary to the protester's assumption that the cost principles of CAS and FAR Part 31 govern the calculation of component costs for purposes of the Buy American Act, it is well settled that various types of costs which an offeror must account for in performing a cost-type contract subject to CAS and FAR Part 31, are not to be included in the calculation of costs to determine whether an end product is domestic or foreign under the Buy American Act. Examples of such costs include: costs associated with preparing user manuals, Ampex Corp., B-203021, Feb. 24, 1982, 82-1 CPD ¶ 163; and packaging costs, 46 Comp. Gen. 784 (1967). Such costs are not considered sufficiently related to components directly incorporated into the end product to warrant inclusion in the component cost calculation. Similarly, the costs of a particular component under the Buy American Act generally may not include costs the offeror incurs after manufacture of the component has been completed. Examples of such costs include: costs of testing that occurs after the components have been manufactured, Bell Helicopter Textron, 59 Comp. Gen. 158 (1979), 79-2 CPD ¶ 431; Patterson Pump Co. et al., B-200165 et al., Dec. 31, 1980, 80-2 CPD ¶ 453; costs of transporting the end product to the place where it will be used, Unicare Vehicle Wash, Inc., B-181852, Dec. 3, 1974, 74-2 CPD ¶ 304; and costs of combining

⁴The agency agrees that if the factor for Ilex's G&A expense had been applied to the cost of the foreign component, Ilex's proposal would have been evaluated as a foreign end product and, after application of the Buy American Act differential, award would have been made to Cryptek as the low offeror.

previously manufactured components to form the end product, 35 Comp. Gen. 7 (1955).

Regarding inclusion or exclusion of indirect costs in Buy American Act component cost calculations, this Office has described the matter as "admittedly . . . a close question," 35 Comp. Gen. 7, 9 (1955). It is, however, clear that the cost of individual components should be calculated "in a similar manner insofar as possible," *id.*, and component costs should be compared "at equivalent levels of processing," 39 Comp. Gen. 695 (1960). Accordingly, since the price paid for a component purchased in final form from another manufacturer includes the indirect costs of that manufacturer, an offeror that manufactures components in-house may include in the cost of those components its own costs for "labor, plus overhead and general and administrative rates," 50 Comp. Gen. 697 (1971);⁵ provided, however, that such inclusion of indirect costs must be limited to the components the offeror itself manufactures. *Id.*; see also, A. Hirsh, Inc., 60 Comp. Gen. 262 (1990), 90-1 CPD ¶ 247; Bell Helicopter Textron, *supra*.

Here, the record clearly establishes that Ilex, itself, manufactures the domestic components to which it applies G&A expense in calculating component costs. Since the costs of the components Ilex purchased already included the G&A expense of the manufacturer, the agency acted properly in similarly including the manufacturer's (that is, Ilex's) G&A expense in the component cost calculation of the components Ilex manufactured. Because the purchased components, including the foreign component, were completely manufactured when Ilex acquired them, all G&A expenses Ilex incurred with regard to the purchased components (for example, costs for storage, insurance and billing) are attributable to manufacture of the end product not the components. Thus, Ilex's G&A was properly excluded from the cost calculations of the purchased components. See Bell Helicopter Textron, *supra*; Patterson Pump Co. et al., *supra*; Unicare Vehicle Wash, Inc., *supra*.

⁵Cryptek argues that our decision in 50 Comp. Gen. 697 permitted only the inclusion of indirect costs that have been approved by the Defense Contract Administration Service (DCAS) or its successors. Although that case involved a situation where DCAS had, in fact, approved the indirect rates, the holding in that decision is not so limited. Cryptek's narrow interpretation of that case would curtail application of the principle that components manufactured in-house should reflect costs similar to those of components purchased from outside manufacturers, unreasonably limiting its application to only those offerors for which a pre-award audit has been performed.

In short, Cryptek's position that the calculation of component costs for Buy American Act purposes is governed by the cost principles of the CAS and FAR Part 31 is inconsistent with the well-established body of law which does not apply those cost principles, and instead removes from the Buy American Act cost calculations particular costs which would otherwise have to be accounted for in a specifically defined manner pursuant to CAS and FAR Part 31. See, e.g., A. Hirsch, Inc., supra; Bell Helicopter Textron, supra; Ampex Corp., supra.

Cryptek also argues that the application of G&A only to components which Ilex manufactures in-house permitted Ilex to "double dip," or "shift" indirect costs to the domestically manufactured components. Specifically, Cryptek asserts:

"Ilex first charges G&A associated with its domestic components on the domestic components. Ilex then also charges G&A properly allocable to the foreign item to the domestic items. Thus, all the expenses incurred by the company to support the purchase, receiving, insurance, storage and accounting for the foreign item, are borne by the domestic components. . . . The obvious effect of this sleight of hand is to artificially inflate the costs of the domestic components at the expense of the foreign components."

To the extent Cryptek's argument is based on the assumption that all of the G&A expenses incurred by Ilex are added to the cost of the components manufactured by Ilex, Cryptek is in error. Cryptek's allegations appear to assume that Ilex's G&A rate was calculated by dividing the G&A costs only by the cost of the components to which G&A was applied, that is, to components Ilex manufactured in-house. Such a calculation would artificially inflate the G&A factor thereby improperly "shifting" costs to the components manufactured in-house. We find Cryptek's assertion that Ilex "double dip[ped]" or "shifted" G&A expenses from the foreign component to the components manufactured in-house without merit since the record establishes the contrary. At the hearing conducted in this protest, an Ilex witness testified that Ilex's G&A factor was derived by dividing its G&A expenses by the total cost of goods sold for its fax machine product line. Video Transcript (VT) at 16:07-16:08. There is no evidence in the record challenging Ilex's assertion in this regard. Thus, Ilex's G&A expenses were allocated on a total cost input base--including both foreign and domestic component costs of the products offered in this procurement, as well as the costs of other products in Ilex's fax machine product line which benefitted from the G&A expenses.

REASONABLENESS OF COSTS

Cryptek also protests that the costs associated with the components Ilex manufactures in-house are so high as to be "unreasonable on their face." Based on a reverse engineering effort performed by its technical personnel, Cryptek maintains that the four components Ilex manufactures in-house⁶ are "of minimal technical sophistication . . . and could not possibly cost more than 50 percent of the total cost of the end product."

In responding to the contracting officer's request for cost data, Ilex provided a breakdown of costs from its standard factory cost accounting system showing that the labor, material, and manufacturing overhead costs associated with the four components it manufactured in-house amounted to \$490.72.⁷ Based on a reverse engineering effort, Cryptek produced its own breakdown of the costs of labor, materials and manufacturing overhead it asserts it would incur if it were to manufacture the four components manufactured by Ilex. Cryptek asserts that its aggregate costs would not exceed \$321.17--that is, 35 percent less than Ilex's cost.

Even if we accept Cryptek's assertion that it could produce the components at the lower cost presented, we find no basis to conclude that Ilex does not, in fact, incur the costs it presented to the contracting officer. Ilex presented testimony that the costs presented are its actual costs, VT at 15:28-15:29, and there is no evidence that this is untrue. We recognize that labor, material and overhead costs are subject to fluctuation depending on a variety of factors including the area where manufacturing occurs, the size and age of the manufacturer's facility, the quantity of products produced, the manufacturer's commercial relationships with its suppliers, and the size and quality of the labor pool available. Accordingly, Cryptek's assertion that it could manufacture the components at an aggregate cost 35 percent less than Ilex's costs, does not provide a disparity of such a magnitude as to establish that Ilex's costs are "unreasonable on their face."

⁶Although Ilex asserts that the user manual it creates constitutes a fifth domestic component, the contracting officer properly excluded the costs associated with this manual from the Buy American Act calculations. See Ampex Corp., supra.

⁷Because much of the information considered in this protest is proprietary and subject to protective order, our decision here discusses only general facts and aggregate costs.

Cryptek also challenges Ilex's G&A rate as unreasonable. In arguing that Ilex's G&A rate is excessive, Cryptek submitted a commercial publication containing a recently conducted survey of government contractors, which stated in pertinent part:

"G&A rates tended to decrease as revenues increased; 76% of companies with less than \$5 million in sales reported [G&A] rates of 10% or higher and only 62% of companies with over \$20 million in sales⁹ reported similar rates."
[Emphasis added.]

In arguing that Ilex's G&A rate is unreasonable, Cryptek represented that the above quotation "shows that the overwhelming majority of companies with sales over \$20 million reported G&A rates of only approximately 10 percent." [Emphasis added.] Contrary to Cryptek's representations, the above quotation does not establish anything with regard to a "ceiling" under which most companies' G&A rates fall; rather, the document merely establishes a "floor" which a majority of government contractor's G&A rates exceed. Further, contrary to the proposition that Ilex's G&A rate is unreasonable, the document indicates that a majority (62 percent) of companies with annual sales in the same range as Ilex also have G&A rates in the same range as Ilex, that is, "10 percent or higher."

In any event, as with costs for labor, material, and overhead, G&A rates may vary widely between industries and between companies in the same industry, depending on a variety of factors. Such factors may include differences in research and development efforts, differences in bid and proposal preparation efforts, and differences in size and make-up of administrative staffs. Based on the record presented, we cannot conclude that Ilex's G&A rate was unreasonable.

CONTRACTING OFFICER'S INDEPENDENT DETERMINATION

Finally, Cryptek protests that the contracting officer's determination to award a contract to Ilex was flawed because it was not the product of her own independent judgment. In

⁸Ilex's G&A rate is more than 10 percent. In light of the extremely proprietary nature of this type of information, we will not be more specific.

⁹Ilex's most recently reported annual sales were approximately \$22 million according to a November 1991, Dun and Bradstreet report.

raising this issue, Cryptek specifically refers to the following exchange that occurred during the hearing:

"Protester's Counsel: In determining what a cost is for purposes of the Buy American Act, how did you determine what a cost was?

Contracting Officer: I relied on the information from my attorneys.

Protester's Counsel: So you didn't make an independent decision?

Contracting Officer: Not really.

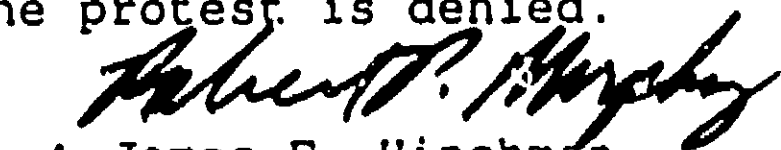
Protester's Counsel: Can you explain to me why you accepted [Ilex's component cost calculation] when the most expensive [foreign] component has zero burden applied to it, and all the burden is shifted to the domestic components? Can you explain that to me?

Contracting Officer: I basically relied on the information provided to me by my attorneys." VT at 13:54

The record indicates that, although the contracting officer relied on and accepted the advice of her legal experts with regard to the proper application of the Buy American Act, she was intimately involved in the procurement throughout the evaluation and selection process. At the hearing, she testified that, despite her deference to counsel regarding the legal issues which played a part in her decision, ultimately, she was responsible for and, in fact, made the decision to award a contract to Ilex. VT at 13:40.

Cryptek suggests that the contracting officer's willingness to accept advice from her legal experts regarding legal issues which affected her award decision rendered the final award decision improper. We disagree. The contracting officer's decision to accept the advice of her legal experts on legal issues reflects reasoned logic and sound judgment, and her decision to award a contract after considering and accepting the advice of those experts constituted an appropriate exercise of her own independent judgment.

The protest is denied.


James F. Hinchman
General Counsel